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CITATIONS

238944—40

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 100

E. R. HAWKE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 165–186) is reported in 35 B. T. A. 784. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 216–237) is reported in 109 F. (2d) 946.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Ninth Circuit was entered on February 26, 1940. (R. 238.) Petition for a writ of certiorari was filed May 24, 1940. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

By a contract of employment executed in 1927, taxpayer received an option to buy certain stock, at book value, upon the termination of his employment. The fair market value of the stock at the time of the contract has not been shown. In 1929, taxpayer purchased such stock, pursuant to the right conferred by the contract, at a price much less than fair market value in 1929. In determining gain upon a subsequent sale, is the basis of the stock its cost or the fair market value in 1929?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.
>
> (a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *
>
> * * * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 51. *What included in gross income.*—* * *
>
> Where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less

> than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition by the shareholder or the employee. * * *

STATEMENT

The relevant facts, as found by the Board of Tax Appeals (R. 166–172), may be summarized as follows:

In 1927, the taxpayer was, and for many years had been, an employee of the J. C. Penney Company. (R. 166.) By a written contract of April 25, 1927, the J. C. Penney Company reemployed the taxpayer as manager of one of its stores. This contract gave the taxpayer the right, at such time as he ceased to be the manager of the store, to buy at book value certain common stock of the company, the precise amount to be determined in accordance with a formula contained in the contract. (R. 167.) No finding was made, nor was any evidence introduced, as to the fair market value of the stock on April 25, 1927. On March 18, 1929, the J. C. Penney Company informed the taxpayer that it elected to terminate the employment contract of April 25, 1927, and that the taxpayer had the right thereunder to buy 971 shares of common stock at

$28 per share. (R. 167–168.) Taxpayer immediately exercised this right. At the date of purchase, the fair market value of the stock was $367.50 per share. (R. 168.) The taxpayer did not include as income in his tax return for 1929 the differential between the fair market value and the price paid for the stock. (R. 170.)

In 1930 and 1931 the taxpayer sold certain shares of this stock. (R. 172.) The question here presented relates to the computation of the profit upon those sales. In determining the deficiencies herein, the Commissioner used as the basis of the shares to the taxpayer, the amount which he actually paid for them, rather than the fair market value at the time of acquisition. (R. 172.) The Board of Tax Appeals sustained the Commissioner's determination, and the court below affirmed.

ARGUMENT

Petitioner urges issuance of the writ on the ground that the decision of the Circuit Court of Appeals is in conflict with the decisions in *Salvage* v. *Commissioner,* 76 F. (2d) 112 (C. C. A. 2d), affirmed, 297 U. S. 106, and *Robinson* v. *Commissioner,* 59 F. (2d) 1008 (C. C. A. 6th). The allegation of conflict with these decisions indicates a misapprehension of the basis upon which the present case was decided below.

The *Salvage* and *Robinson* cases merely hold that where a corporation sells an officer or employee shares of its stock at a "bargain price", without

having given him any antecedent option to purchase the shares of stock, the basis of the stock for purposes of determining capital gain or loss upon its subsequent disposition is the fair market value of the stock at the time of the bargain purchase.

The court below did not reject the rule enunciated in these cases. It held, however, that the rule is inapplicable where, as here, the sale of stock by the corporation was made pursuant to an antecedent option. In such a situation, the court held, the additional compensation, if any, given by the corporation to its officer or employee is the value of the option at the time of its issuance and not the differential between the option and market price of the stock at the time of the exercise of the option. In this view, if, as must be assumed to be the case here in the absence of proof to the contrary, the option had no ascertainable market value at the time of its issuance, the officer or employee received no additional compensation from the corporation, even though, due to subsequent market fluctuations in the value of the stock, the option later became of substantial value. Cf. *Palmer* v. *Commissioner,* 302 U. S. 63. The court held, therefore, that under the particular facts of this case the taxpayer had not proved that he had received additional compensation and that the cost basis of the stock must consequently be deemed to be the amount of the cash which he paid for the stock.

This holding of the court below is not in conflict with any decision of this Court or of any other Cir-

cuit Court of Appeals and it presents no question of general importance.

CONCLUSION

For the reasons stated, we respectfully submit that the petition for a writ of certiorari should be denied.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HOWARD D. PACK,
Special Assistants to the Attorney General.

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